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The Director of Central Intelligence

Washington, D.C. 20505

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National Intelligence Council

NIC 04945-85
2 October 1985

MEMORANDUM FOR: Herbert E. Meyer
Vice Chairman, National Intelligence Council

FROM: Deane E. Hoffmann
Acting National Intelligence Officer for Economics

SUBJECT: Soviet Oil: Gorbachev's Alternatives

1. Community analysis of Soviet oil problems to date has focused on the possibility that there would be a significant decline in Soviet oil production and related hard currency export earnings.

- A March 1985 SOVA paper used as a "worst case" scenario a decline in production to 11 million b/d by 1990 (from a 1983 peak of 12.3) and a \$10 billion loss in real hard currency earnings, implying a reduction in total earnings of roughly one-third.
 - In the "best case" gas scenario, natural gas exports could only make up a fraction of this loss.
2. Events so far in 1985 have overtaken these "worst case" estimates.
- Oil production is running 4% or roughly 500,000 b/d below last year's levels and exports to many firms in Western Europe are already being reduced by one-third to one-half.
 - This decline in production continued throughout the summer despite a major effort that began early this year to repair out-of-service wells. Equipment shortages have prevented any headway in this effort.

3. While it is still possible that Gorbachev's efforts to throw more resources at the problem will slow the rate of decline for a time, we must now consider the repercussions of a failure of this effort. The oil problems pose some real challenges for Gorbachev.

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- Absent the oil decline, Gorbachev could have continued to use traditional measures to flog an additional percentage point or two of growth from the economy over the next year or two. This would have given him time to consider and, perhaps, set the stage for more radical systemic changes down the road.
4. The oil decline forces his hand and, absent an unexpected leveling off in production, will make him consider more radical solutions. His options for dealing within the system seem limited.
- Deep-rooted problems prevent delivery of adequate equipment to prevent further oil production problems. On-site management problems compound the difficulties.
 - Similar systemic problems prevent progress at "conservation" in industry and the economy in general.
 - Gas substitution faces the same difficulties, although we are less sure about the potential for further inroads here.
 - Additional cuts in oil deliveries to Eastern Europe could cause severe industrial problems and further injure the political relationship.
5. Short of a radical military solution, Gorbachev does have some high-risk bureaucratic options.
- More imports of Western equipment and the introduction of Western technicians and, perhaps, management in oil fields.
 - Establishment of joint ventures with Western firms in the Barents Sea or elsewhere.
 - Enlisting Western help in gas substitution.
6. All of these alternatives carry an indeterminate payback in exchange for major systemic change, however. One key theme in the past has been optimism over the ability of the economy to respond on its own. Indeed, many will feel that by taking such options now Gorbachev would be admitting defeat before his economic reform program even got off the ground.

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- By failing to take radical action now, however, Gorbachev may be buying even more serious energy problems for the future and increasing the chance for a high-risk military solution.



Deane E. Hoffmann

Attachments:

- A. USSR: Implications of Reduced Oil Exports (Summary)
B. Western Technology and Equipment and Soviet Energy

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